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No. 95-1784

In the Supreme Court of the United States

OCTOBER TERM, 1995

DAVID A. KOSS AND FREYA B. KOSS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioners satisfied the requirements for application of the mitigation provisions of the Internal Revenue Code, 26 U.S.C. 1311-1314.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 69 F.3d 705. The opinion of the district court (Pet. App. 21a-25a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 7, 1995. Pet. App. 19a-20a. A petition for rehearing was denied on January 25, 1996. Pet. App. 27a. The petition for a writ of certiorari was filed on April 24, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1974, petitioner David Koss received 22,000 shares of Video Systems Corporation stock from a client in settlement of a dispute over compensation for legal services. Petitioners David and Freya Koss reported the transfer of the 22,000 shares as ordinary income in the amount of $4,400 on their joint income tax return for 1974. In 1977, the Internal Revenue Service commenced an examination of that return (Pet. App. 2a-3a, 22a).

On December 5, 1980, the Service issued a notice of deficiency with respect to petitioners' 1974 return. The deficiency was based on the determination that the fair market value of the stock received in 1974 was $110,000 rather than the $4,400 stated on the return. Petitioners sought review of the asserted deficiency in the Tax Court (Pet. App. 3a, 23a).

The Tax Court upheld the deficiency, concluding that the stock that petitioner received in 1974 had a fair market value of $110,000 in that year (Pet. App. 3a, 23a). The Third Circuit affirmed. *Koss* v. *Commissioner*, 57 T.C.M. (CCH) 882 (1989), aff'd, 908 F.2d 962 (3d Cir. 1990). That decision became final on September 23, 1990, when the time for filing a petition for a writ of certiorari expired (Pet. App. 3a, 23a). See 26 U.S.C. 7481(a)(2)(A).

2. The 1977 income tax return filed by petitioners made no claim of any sort with respect to the stock received by petitioners in 1974. On August 3, 1991, however, petitioners amended their income tax returns for 1977 and 1974 to assert that the stock they received in 1974 became worthless in 1977. The amended returns claimed that the loss from the worthless stock was greater than petitioners' reported income for 1977 and therefore resulted in zero tax liability for petitioners for that year. Petitioners therefore requested a refund of the taxes they paid for 1977. They also sought to carry back the excess loss to 1974 and requested an adjustment of the taxes determined by the Tax Court for that year (Pet. App. 3a-4a, 23a-24a). With the amended return, petitioners paid a tax of $2,148 for 1974, which they computed was the amount due after application of the carryback loss (*id.* at 4a).

The Service disallowed the requested adjustments. Petitioners then filed this refund suit (Pet. App. 4a, 24a).

3. The district court noted that petitioners' 1991 refund claim for 1977 taxes was filed long after it was barred by the statute of limitations in 26 U.S.C. 6511. The court therefore awarded summary judgment to the government (Pet. App. 24a-25a).

The court rejected petitioners' argument that the mitigation provisions of 26 U.S.C. 1311-1314 permit the untimely suit to proceed. The court held that those provisions are inapplicable because the Service had not taken any inconsistent position in making its determinations of petitioners' tax liabilities (Pet. App. 25a). Petitioners did not claim any loss on their 1977 return with respect to the stock. The Service thus took no position at all regarding the basis of the stock in 1977—and necessarily took no position that was inconsistent with the determination made by the Service with respect to the value of that stock in 1974 (*ibid.*).[1]

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[1] The district court also rejected petitioners' assertion that they were entitled to relief under the doctrine of equitable

4. The court of appeals affirmed (Pet. App. 1a-20a). The court agreed that the refund claim for 1977 had long been barred by the statute of limitations in 26 U.S.C. 6511 (Pet. App. 5a-6a). The court further held that the refund claim for 1974 was, in addition, precluded (i) by petitioners' failure to pay the full tax owed before bringing suit, as required by *Flora* v. *United States*, 362 U.S. 145, 177 (1960) (Pet. App. 6a); (ii) by the alternative statute of limitations applicable to carrybacks of net operating losses in 26 U.S.C. 6511(d)(2)(A) (Pet. App. 7a); and (iii) by 26 U.S.C. 6512(a), which bars a refund suit for the same tax year for which the taxpayer previously filed a petition in Tax Court (Pet. App. 7a-8a).

The court rejected petitioners' contention that the mitigation provisions of the Internal Revenue Code permit their untimely suit to proceed. The court stated that petitioners' suit did not invoke the mitigation provisions because the error they sought to correct—their failure to report a loss in 1977—did not occur "in respect of any transaction on which such basis depends," as required by 26 U.S.C. 1312(7)(A) (Pet. App. 13a).

The court further held that, even had the suit satisfied the requirements of 26 U.S.C. 1312(7)(A), it would still be barred because it failed to satisfy the requirement in 26 U.S.C. 1311(b)(1) that the Service maintain a position (for 1977) that is inconsistent with its prior determination (for 1974). The court explained that, since petitioners did not declare any loss with respect to the stock on their 1977 return, the IRS could not have taken any position concerning

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recoupment (Pet. App. 25a). The court of appeals upheld that ruling (*id.* at 17a), which is not addressed in the petition.

that stock in 1977 and thus could not have taken a position inconsistent with its position in the Tax Court litigation (Pet. App. 16a).

DISCUSSION

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Petitioners filed their claims for refund long after the time for such claims had expired pursuant to 26 U.S.C. 6511. See Pet. App. 5a. Petitioners sought to overcome the statute of limitations by resort to the "mitigation" provisions of the Internal Revenue Code, which allow for corrections of errors that would otherwise be "prevented by the operation of any law or rule of law." 26 U.S.C. 1311(a). The court of appeals correctly held (Pet. App. 16a) that the statutory prerequisites for application of the mitigation provisions are not satisfied in this case.

The Code imposes numerous prerequisites for application of the mitigation provisions. First, there must be a "determination" which, as defined by statute, includes (as is relevant here) a Tax Court decision that has become final. 26 U.S.C. 1313(a)(1). Second, the "determination" must be one of the seven specified "circumstances of adjustment" described in 26 U.S.C. 1312. 26 U.S.C. 1311(a). Third, the correction of the error in the year that is the subject of the suit must, at the time of the determination, be "prevented by operation of any law or rule of law." *Ibid.* Fourth, the party against whom the mitigation provisions are being invoked (in this case, the Commissioner) must have maintained a position with respect to the determination involved in the current

suit that is inconsistent with the treatment of that same item in a closed year. 26 U.S.C. 1311(b)(1).

The court of appeals correctly rejected petitioners' contention that the proposed correction of their tax liability for 1977 falls within the "circumstances of adjustment" described in Section 1312(7) of the Code. Section 1312(7) concerns the correction of errors with respect to the basis of property. To qualify for relief under Section 1312(7), petitioners were required to demonstrate the existence of four conditions: (i) that there was a prior determination of the basis of the property;[2] (ii) that there is a "transaction on which such basis depends or * * * [a] transaction which was erroneously treated as affecting such basis"; (iii) that, "in respect of" that transaction, there occurred an error listed in Section 1312(7)(C);[3] and (iv) that the error occurred with respect to "the taxpayer with respect to whom the determination was made." 26 U.S.C. 1312(7)(B); see *O'Brien* v. *United States*, 766 F.2d 1038, 1042 (7th Cir. 1985).

Petitioners do not meet the third requirement. As the court of appeals correctly held, petitioners' claim for relief under the mitigation provisions fails, among other reasons, because (Pet. App. 11a-12a):

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[2] That requirement is met in this case by the prior decision of the Tax Court that the property had a value of $110,000 when it was received in 1974.

[3] The errors listed in Section 1312(7)(C) are: (i) "erroneous inclusion in, or omission from, gross income," (ii) "erroneous recognition, or nonrecognition, of gain or loss," and (iii) "erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible." Petitioners contend that there was an erroneous nonrecognition of loss in 1977 when the Video stock allegedly became worthless (Pet. App. 11a).

> the error they specify was not due to the determination by the Tax Court of the 1974 basis of the shares. The nonrecognition in the 1977 return of the loss of the value of the shares was caused by the [petitioners'] failure to declare that they had any loss at all.

The court thus correctly concluded that the requisite causal connection between the determination of basis in 1974 and the nonrecognition of loss in 1977 did not exist.

The court of appeals observed that, even if there was some causal factor between the determination of basis and the nonrecognition of loss if and when the stock became worthless in 1977 (Pet. App. 13a):

> the error alleged here, the nonrecognition of loss resulting from the worthlessness of the stock in 1977, similarly was not "in respect of any transaction on which such basis depends." 26 U.S.C. § 1312(7)(A). The basis of the shares in the determination depended on the transaction in which [petitioner] acquired them in 1974. The basis of the shares did not depend on their becoming worthless in 1977. Thus, the error in failing to recognize the shares' loss in value did not occur "in respect of" their acquisition by [petitioner] in 1974.

As the court of appeals correctly stated, the Service did not assert inconsistent positions, as required by 26 U.S.C. 1311(b)(1) (Pet. App. 15a-16a). In the Tax Court litigation, the Service took the position that petitioners undervalued the Video stock *at the time it was received, in 1974*, and contended that the fair market value of the stock *in that year* was $110,000, rather than $4,400 as reported by

petitioners. The Tax Court agreed with the Service's position. Nothing in that decision addressed what value, if any, the stock had in 1977—the year that petitioners now belatedly claim that the stock became worthless.

In short, the conclusion that the stock was worth $110,000 in 1974 is not inconsistent with *any* conclusion as to the value of that stock in 1977. The fact that petitioners failed to claim a loss for the alleged worthlessness of the stock in 1977 is entirely independent of the prior determination of the value of that stock in 1974.

2. a. Petitioners contend (Pet. 6-7) that the decision in this case conflicts with *United States* v. *Rushlight*, 291 F.2d 508 (9th Cir. 1961). Petitioners claim that *Rushlight* stands for the proposition that the requirement of Section 1312(7)(A) that the error to be corrected must be "in respect of" the "transaction on which * * * basis depends" is satisfied when "the disposition transaction is also a transaction on which the basis of property depends" (Pet. 6).

In *Rushlight*, the taxpayers were partners of a partnership that owned certain steel mill equipment. The partnership claimed to have abandoned that equipment in 1945 and claimed a deduction for an abandonment loss in that year. If that deduction were valid, the basis of the steel mill equipment would be reduced to zero. The Service determined, however, that the equipment had not been abandoned. That determination was subsequently upheld by the Tax Court. In the interim, however, the taxpayers had taken possession of the equipment, sold it, and reported capital gains based upon an adjusted basis of zero. After the Tax Court upheld the Service's

determination, the taxpayers claimed that they had erroneously reported the capital gains because the basis in the equipment, as determined by the Tax Court, exceeded the sale proceeds. 291 F.2d at 511-512. The court held in *Rushlight* that the taxpayers were entitled to relief under the predecessor of Section 1312(7) because "a determination of basis at the time of disposition of the property can properly be said to be 'in respect of any transaction upon which such basis depends,' i. e. the transaction referred to is the transaction in which the property was acquired, and the basis of the property at the time of disposition can be said to depend on such transaction." 291 F.2d at 516.[4]

In the present case, by contrast, the claimed error —the nonrecognition of loss in 1977 when the stock became worthless in that year—had no relationship to the determination of the basis of the stock in any other year. Petitioners simply failed to claim *any* loss in 1977 with respect to the stock. This failure alone led to the nonrecognition of the belatedly asserted loss.

b. Petitioners also contend (Pet. 7) that the decision in this case conflicts with *Chertkof* v. *United States*, 676 F.2d 984 (4th Cir. 1982), although they do not explain the nature of the conflict. In *Chertkof*, the taxpayers reported gains from sales of inherited stock using the basis of the shares as reported on the

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[4] Petitioners err in asserting that *Rushlight* holds that the disposition transaction is the basis determining transaction. Instead, as the court also held in the present case (Pet. App. 12a), the *Rushlight* court held that the transaction upon which basis depends is the "transaction in which the property was acquired." 291 F.2d at 516.

estate tax return. *Id.* at 986. In a subsequent suit involving the estate, the Tax Court determined greater values for the shares than the estate had reported. *Id.* at 985-986. The taxpayers then sought refunds of the income taxes paid on the gains they reported from disposition of the stock. The court held that the sales of stock did not qualify under the mitigation provisions as "transaction[s] on which such basis depends," as required by Section 1312(7)(A), but were only "transactions which depend on basis." 676 F.2d at 992. The court allowed relief only on the separate ground that the acquisition of the stock by inheritance constituted a basis-determining transaction. That rationale obviously has no application to the present case. *Id.* at 993.

3. Finally, petitioners assert (Pet. 9) that the court of appeals erred in this case by holding that the requirement of inconsistent treatment that is imposed by Section 1311(b)(1) is met only if there is an "active" inconsistency on the part of the IRS. The court of appeals did not, however, adopt an "active" inconsistency standard. Instead, the court held that, because petitioners failed to claim *any* loss whatsoever for the alleged worthlessness of the stock on their 1977 return, the Service simply took *no* position —certainly not an inconsistent position—on the value of the stock in that year. As the court summarized (Pet. App. 16a):

> [T]he IRS accepted their 1977 return without notice that the shares were worthless. Surely, the IRS is not required to verify the value of the capital assets of all taxpayers each year to make sure they have not become worthless. Thus, its acceptance of the 1977 return that did not declare

> such a loss, at whatever value, is not inconsistent with its successful position in Tax Court that the shares had a basis of $110,000 to the [petitioners] in 1974.

The court concluded that "the IRS could not have maintained inconsistent positions because when [petitioners] filed their 1977 return they did not declare that the shares became worthless in that year and, thus, they did not put the IRS on notice of that fact" (*ibid.*).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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